No. 13503

IN THE

United States Court of Appeals
For the Ninth Circuit

Giulio Particelli, *Petitioner*

v.

Commissioner of Internal Revenue, *Respondent*

Estate of Eletta Particelli, Deceased, and
Arthur Guerrazzi, Executor, *Petitioners*

v.

Commissioner of Internal Revenue, *Respondent*

On Petitions for Review of the Decisions of the Tax Court of the United States

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BRIEF FOR THE RESPONDENT

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On Petitions for Review of the Decisions of the Tax Court of the United States

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BRIEF FOR THE RESPONDENT

OPINION BELOW

The memorandum findings of fact and opinion of the Tax Court (R. 59-79) are not officially reported.

JURISDICTION

The petitions for review in these cases involve deficiencies in income and victory taxes asserted against the taxpayers by the Commissioner and redetermined by the Tax Court in the total sum of $100,270.72 on the

basis of their community income for the calendar year 1943. (R. 80-81, 82-88.) On July 21, 1949, the Commissioner mailed to the taxpayer and his wife separate notices of deficiencies in income and victory taxes in the sum of $62,222.85 each, aggregating $124,445.70, for 1943. (R. 11-19, 31-33.) Within ninety days thereafter and on October 17, 1949, they filed petitions with the Tax Court for redetermination of such deficiencies under the provisions of Section 272 of the Internal Revenue Code.[1] (R. 3-19, 25-33.) The decisions of the Tax Court redetermining and sustaining in large part the deficiencies asserted by the Commissioner were entered on May 1, 1952.[2] (R. 80-81.) The cases are brought to this Court by the petitions for review filed by the petitioners on July 21, 1952[3] (R. 82-84, 86-88), pursuant to the provisions of Section 1141 (a) of the Internal Revenue Code, as amended by Section 36 of the Act of June 25, 1948.

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[1] The taxpayer's wife having died on October 12, 1949, her executor, Arthur Guerrazzi, filed the petition in behalf of her estate for redetermination of the deficiency by the Tax Court on October 17, 1949 (R. 25-33), and an amendment thereto on January 3, 1950 (R. 39-40), and he was substituted as party-petitioner by order of the Tax Court entered on November 21, 1949 (R. 34-35; Pet. Br. 1-2). Since the tax liabilities of both petitioners depend entirely upon the business transactions of taxpayer Giulio Particelli, our references hereinafter in the singular to "the taxpayer" are to him, in the plural, to both petitioners.

[2] The deficiencies redetermined by the Tax Court (R. 80-81) in lesser amounts than those determined by the Commissioner are accounted for in part by the fact that several other issues were settled in the Tax Court by stipulation of the parties (R. 59).

[3] These cases were consolidated for purposes of hearing and disposition in the Tax Court (R. 59), and also for purposes of briefing, argument, single proceeding and record in this Court by order entered on August 2, 1952 (R. 91), pursuant to stipulation of the parties (R. 90).

QUESTION PRESENTED

The taxpayer sold his wine inventory of 275,000 gallons, together with his winery plant and equipment, for the total sum of $350,000 in the taxable year 1943 under a contract of sale specifying that amount as the selling price of both the wine and the winery, without specifying the *actual* consideration for each class of property. The Tax Court, upholding the propriety of the Commissioner's method of allocation to reflect the real consideration paid for the wine and the winery, allocated the entire proceeds of the sale as a lump-sum payment attributable to the wine and the winery in the respective amounts of $275,000 and $75,000, based on the fair market value—in excess of the ceiling price established by the Office of Price Administration—of $1 a gallon for the wine at the time of the sale on December 6, 1943.

The question presented is whether the Tax Court correctly sustained in most part the Commissioner's determination allocating the proceeds as a lump-sum payment derived from the sale of the taxpayer's wine inventory and winery plant in the taxable year 1943 between ordinary income and capital gain, on the ground that a consideration of the actual substance of the transaction shows that the allocation provisions of the written contract of sale were self-serving and wholly inoperative and therefore did not reflect the real agreement between the parties.

STATUTE INVOLVED

The pertinent provisions of the statute involved are printed in the Appendix, *infra.*

STATEMENT

The pertinent facts—some of which (including exhibits) were stipulated by the parties (R. 43-58) and found by the Tax Court by reference accordingly (R.

59)—were found by the Tax Court as follows (R. 59-70):

The taxpayer Giulio Particelli, a resident of Sebastopol, California, and the decedent were at all times material husband and wife. Giulio Particelli, whose transactions gave rise to the question in issue, will be referred to for convenience as the taxpayer. (R. 59-60.)

The taxpayer was born in 1891 and migrated to this country from Italy. He speaks and understands but can not read English. His spoken English is a somewhat broken dialect and is difficult for those not accustomed to it to understand. (R. 60.)

The taxpayer commenced the production of wine on a small scale on his farm shortly after the repeal of prohibition. In 1941 he commenced and, prior to the grape crush in 1943, fully completed the construction of a larger winery at Forestville, California, known as the Lucca Winery. The winery was equipped to crush grapes, to ferment the juice into wine, to rack and filter wine and store 256,000 gallons. The winery was not equipped to finish wine beyond the aging, racking and filtering stages. The taxpayer's equipment for bottling wine was located in his retail store, which was located about 300 feet from the winery. (R. 60.)

Prior to October 22, 1943, the Office of Price Administration (hereinafter referred to as OPA) had a ceiling on bulk dry wine of 21½¢ a gallon, plus an amount not in excess of 6¢ a gallon, computed on the basis of cost of grapes in 1942 over 1941, not exceeding $28.20 a ton. Effective October 22, 1943, the OPA placed a flat ceiling of 28¢ a gallon, and 33¢ a gallon on bulk current red and white wines, respectively. At the same time it set flat ceilings for bottled wines. (R. 60.)

The taxpayer sold wine of his own production and of established winemakers. His wine was not finished and was the poorest and cheapest of the grades which he

sold. His own wine would cloud and he could not sell it in bottles. He sold his own wine only in bulk in lots of 5, 10, 15, 25 or 50 gallons, or in carload lots when blended with finished wines. He generally sold the other wines in one-fifth, half-gallon and gallon bottles. (R. 60-61.)

Most of the wine sold by the taxpayer in 1943, prior to November of that year, had been purchased from other producers. The various types and classes of the wine were sold from 45¢ to $1.40 a gallon. He sold his own production of wine for 32¢ a gallon in 50-gallon lots, 33 to 35¢ in 25-gallon lots, and 38¢ a gallon in 5-gallon lots. All of the prices included federal and state alcoholic beverage taxes, which in 1943 totaled 11¢ a gallon. (R. 61.)

During the same period the taxpayer made one sale of about 60,000 gallons of wine in carload lots to a winery located in Ohio. The wine so sold was a blend in the ratio of ten parts of his production in 1942 to one part of some finished wine which he had purchased from another winery. The OPA ceiling price for the wine was about 27½¢ a gallon. The proceeds of the sale were $51,800.95. (R. 61.)

The taxpayer's crush of wine in 1943, consisting of about 245,000 gallons, was started in September and was completed in November. At that time he had about 30,000 gallons of wine on hand from his crush of about 100,000 gallons in 1952. The cost of the wine produced by the taxpayer in 1943 was from 50¢ to 52¢ a gallon. At that time he and other wine producers expected that the OPA would increase the ceiling price of wine sold in bulk. (R. 61-62.)

A blend of finished wine with unfinished wine will not produce finished wine. The winery which on two occasions had finished some wine for the taxpayer refused to do so again. Unless he could have his wine fin-

ished or blend it with finished wine the taxpayer could not sell his wine as case goods, because it would cloud and spoil, but he could sell it in bulk. In December, 1943, the taxpayer's prior sources of supply for finished wine in bulk for blending purposes refused to sell him finished wine except as case goods, the price of which made the cost too high to use for blending. (R. 62.)

The taxpayer, since 1934, had a line of credit from the Bank of Sonoma County or its predecessor on a secured and unsecured basis. On December 1, 1943, the taxpayer owed the bank $70,000 secured by all of his assets. (R. 62.)

Orders issued by the Federal Government to control the disposition of grapes created a scarcity of grapes in 1942 and 1943 available for producing wine and intensified the extremely high demand for wine in those years. During 1942 and 1943 the price of grapes was not subjected to regulation by public authority. In 1942 wineries paid an average of $30 a ton for grapes and in 1943 an average of $79. The normal crush of dry wine from a ton of grapes is about 160 gallons. Prior to 1942 about 80% of all the wine produced in California was sold in bulk. Thereafter, there was a trend toward sales of wine in bottles, and by October or November, 1943, bulk sales of unfinished wine had practically ceased. By the end of 1943 bulk sales of unfinished wine at the prevailing ceiling prices had ceased entirely. The cost of grapes in 1943 prevented wine producers from making a profit on bulk sales of unfinished wine at the ceiling price. There was no active market for wineries in 1943 without an inventory of wine. During that year, to obtain wine, bottlers were compelled to buy the winery in order to obtain the owner's inventory of wine. (R. 62-63.)

During 1943 three methods were used by operators of wineries to legally dispose of their inventory of un-

finished wine at prices in excess of OPA ceilings on bulk sales. One of the methods, known as contract or franchise bottling, which was commenced about October, 1943, consisted of shipping the wine to a bottler to be bottled for the account of the winery, and then selling the bottled wine to the bottler. That method enabled the wine producer to obtain from 75¢ to $1.25 a gallon for his wine, depending upon its quality. Another plan, adopted in 1942, consisted of a sale by the wine producer of his inventory of wine and winery in one transaction for a lump sum price. The other method was one in which a bottler acquired the production of a winery by advancing funds for grapes to be crushed for the account of the bottler. The OPA issued a ruling in the fall of 1943 in response to a request of the Wine Institute, a trade and service organization for the wine industry of California, which constitutes about 90% of the wine industry of the United States, that it would not interfere with the contract or franchise bottling method. During 1942, 1943 and 1944, 50 to 60 wineries in California, which constituted more than one-half of the production capacity of wineries in California, were purchased in order to obtain their inventories of wine. Of the 50 to 60 wineries so sold during the period of three years, 20 or 25 were sold in 1943. In 1943 bottlers of wine searched sources of supply for wine and a producer was not required to exert any effort to sell his wine. (R. 63-64.)

In December, 1943, John Dumbra (hereinafter referred to as Dumbra) was in California for the purpose of locating wine for purchase by his employer, the Tiara Products Company (hereinafter referred to as Tiara), general wine merchants, with its principal office in New York City. Dumbra first discussed the purchase of wine from the taxpayer in Santa Rosa, California, the evening of December 4, 1943. After

tasting the wine at the Lucca Winery the next day and finding it satisfactory, Dumbra offered to purchase three or four cars of the wine at the taxpayer's price. The taxpayer's ceiling price for the wine was not discussed. The taxpayer's reply to the offer was that he could not make a profit on sales of his wine in such quantities and as he wished to get out of the winery business, the only transaction he would consider would be one for the purchase of all of his wine and the winery. Further discussions resulted in an offer of the taxpayer to sell his inventory of wine and the winery for $350,000. Dumbra made a counter offer of $330,000, subject to approval of his principal. Later the same day Dumbra consulted his brother, Victor Dumbra, president and general manager of Tiara, who authorized him to buy the wine and winery, paying, if necessary, the asking price of the taxpayer. Tiara did not want the winery but was willing to acquire it, if necessary, to obtain the wine at an overall price it could afford to pay. The taxpayer would not accept less than $350,000 for the winery and his inventory of wine and Tiara accepted the taxpayer's offer to sell at that price. The taxpayer informed Dumbra that "he was going to draw up the whole thing together," specifying one price for the wine and another for the winery and that "the price would be $350,000", to which Dumbra had no objection, provided the price did not exceed $350,000 and the quantity of wine was correct. Dumbra did not at any time agree to purchase the wine for $77,000 and the winery for $273,000. Tiara was compelled to purchase the winery to obtain the wine. While Dumbra at times felt that he was not understanding the taxpayer correctly, all of his doubts in that regard were eliminated before the negotiations were completed. (R. 64-65.)

Dumbra and the taxpayer met in the office of the taxpayer's accountant in San Francisco on December 6,

1943. While there the taxpayer requested his accountant to compute the ceiling price on sales of bulk wine, which he did, and determined a price of not in excess of 28¢ a gallon, and so advised the taxpayer (R. 65). Thereafter, on the same day, the taxpayer and Dumbra, acting for Tiara, executed an instrument reading in part as follows (R. 66):

> Agreement of Sale
>
> Receipt of the sum of $5,000.00 to apply on the total purchase price of $350,000.00 is hereby acknowledged this sixth day of December, 1943, by the undersigned, G. Particelli, for the following purposes:
>
> It is hereby understood and agreed that the said G. Particelli will sell to John Dumbra, and the said John Dumbra agrees to buy, all that certain winery known as Lucca Winery located at Forestville, Sonoma County, California, together with two acres more or less of land on which said winery is located, all buildings now located thereon, all fixtures, equipment, supplies (other than wine), goodwill, trade names, formulas, and all other personal property of every kind and description now belonging to or a part of said Lucca Winery, for the total sum of $273,000.00.
>
> It is further understood and agreed that the said G. Particelli will sell to John Dumbra, and the said John Dumbra agrees to buy, 275,000 gallons of wine now in storage in said Lucca Winery at the total price of $77,000.00.
>
> It is further understood and agreed that the balance of said total purchase price for both the said winery and wine, amounting to $345,000.00, will be paid on or before December 21, 1943, at which time

said G. Particelli agrees to furnish clear title to said real and personal property.

* * * * *

The agreement was drafted by the taxpayer's attorney in accordance with instructions given to him by the taxpayer. (R. 66-67.)

The Bank of Sonoma County acted as escrow agent for the parties in completing the transaction. On December 21, 1943, Tiara's attorney signed on behalf of Tiara, and delivered two letters of instructions to the escrow agent. One of the letters recited that Tiara was transmitting its check for $77,000 for delivery to the taxpayer upon the delivery of a bill of sale for 256,000 gallons of dry table wine located at Lucca Winery and 19,000 gallons of like wine located in the Scatena Bros. Winery, Healdsburg, California. The other letter recited that there was transmitted therewith Tiara's check of $268,000 for delivery to the taxpayer upon receipt of a deed and bill of sale for all of the property in the Lucca Winery other than the wine. The taxpayer directed the escrow agent in writing to deliver his bill of sale for the wine on payment of the amount of $77,000 "which represents a sale of 275,000 gallons of wine at our ceiling price of 28¢ per gallon." Other instructions of the taxpayer to the escrow agent were to deliver the deed and bill of sale covering the winery to Tiara upon receipt of the amount of $268,000 and authorized it to place revenue stamps of $110 on the deed. The revenue stamps were based upon a valuation of $100,000 for the real estate conveyed. The amounts of the checks actually delivered to the escrow agent with the letters were $330,000 and $15,000. Delivery of the deed and bill of sale for the winery was to be made not later than March 1, 1944, but was not actually made until May 1, 1944, on account of delay in obtaining a license in the name of the buyer. The proceeds of the checks totaling

$345,000 were credited to the bank account of the taxpayer on December 31, 1943. (R. 67-68.)

The wine and winery were entered on the books of Tiara at cost prices of $77,000 and $273,000, respectively. The amounts were used as cost in income and excess profits tax returns of Tiara. The entries were made by a bookkeeper under the supervision of Tiara's independent accountant, who obtained the figures entered in the books from the letters of instruction of the taxpayer and Tiara to the escrow agent and the sales contract. The accountant was the tax adviser of Tiara but was not consulted by anyone on behalf of Tiara prior to the purchase about any aspect or consequences of the purchase. The figure of $77,000 was entered in the books as the cost of the wine because that amount was set up in the contract of sale as the selling price. Victor Dumbra did not learn of the entry for the wine until some undisclosed time after it was made. (R. 68.)

Tiara did not in 1943 endeavor to purchase or purchase a winery without wine. It considered that it was paying from $1 to $1.12 per gallon for the wine acquired from the taxpayer, which was a price it could afford to pay in view of the prevailing high ceiling prices for wine in bottles, and the remainder for the winery. Tiara purchased the winery in order to obtain the wine. Tiara could make a net profit of about $2 a gallon on bottled wine, less the cost of the wine itself. (R. 68.)

There was no active market in 1943 and 1944 for wineries without an inventory of wine to sell with them. A few months after acquiring title to the Lucca Winery, Tiara offered the property for sale at the price of $60,000 but would have accepted an offer of $55,000 or $50,000. It refused offers of $40,000 and $45,000. There was a break in the market for wineries producing dry wines and the winery was sold in December, 1944, for $20,000. Tiara's accountant advised it in 1944 that there would

be a tax advantage to it in selling the winery in that year. (R. 68-69.)

Tiara purchased wineries, other than the Lucca Winery, with their inventories of wine. One of such purchases was made in California in December, 1943. At the time of their acquisition Tiara understood that regulations of the OPA permitted it to sell the wine so acquired at its ceiling prices for bulk and case goods. During the latter part of 1944 it learned that such ceiling prices applied only on deliveries of wine to customers from its own facilities and if it made deliveries to the customer from the winery which produced the wine, the applicable ceiling price was the ceiling of the winery which had been purchased. From 40% to 50% of the wine acquired by Tiara from the taxpayer was sold direct to customers from the Lucca Winery. (R. 69.)

The taxpayer was employed by Tiara in December, 1943, at a salary of $100 per week to take care of the Lucca Winery. Before the sale involved herein was closed the taxpayer, with the consent of Tiara, withdrew 1,000 gallons of the wine for his personal use. In May, 1944, when the contract of employment was terminated and Tiara owed the taxpayer $1,500 for his services, the taxpayer allowed Tiara a credit of $1,000 for the wine withdrawn by him. (R. 69-70.)

Of the total consideration of $350,000 involved in the transaction, $275,000 was paid for the wine and $75,000 for the winery. (R. 70.)

In their returns for 1943 the taxpayers reported that the sale to Tiara on December 6, 1943, constituted a sale of wine for $77,000 and the winery for $273,000. Capital gain on the sale of the winery was computed on a cost basis of $61,165, less $5,799 for depreciation. In his determination of the deficiencies, the Commissioner allocated $302,000 of the total selling price to the sale of

wine and $47,500 to the winery and decreased the adjusted cost basis of the winery to $26,420. (R. 70.)

Upon the basis of the foregoing facts, the Tax Court, modifying and upholding in large part the Commissioner's determinations (R. 11-19, 31-33), allocated, as between ordinary income and capital gain, the entire sales price considered as a lump sum payment between the wine and the winery plant based on the fair market value of the wine, in excess of the ceiling price fixed by the Office of Price Administration, at the time of the sale in the taxable year (R. 70-79). The Tax Court thereupon entered its decisions accordingly (R. 80-81), from which the taxpayers petitioned this Court for review (R. 82, 86).

SUMMARY OF ARGUMENT

It is clear, upon a consideration of all the evidence, that the transaction here in question was in substance a sale of two classes of property for the total consideration of $350,000, without any *bona fide* agreement of the parties as to the real price of each class of property involved. The determination of the issue is a question of fact for the Tax Court, and its findings in respect thereto may not be properly set aside where they are supported by substantial evidence, as here. The Tax Court found, upon a consideration of all the evidence, facts and circumstances considered as a whole, that the written contract of sale does not reflect the real agreement of the parties thereto, that the substance of the transaction between them was the sale of the wine and the winery for a lump-sum consideration without any actual agreement as to the selling price for each class of property, and that accordingly the wine was sold for $1 a gallon fair market value, or $275,000, and the winery for the remainder, or $75,000. These findings, contrary to the taxpayer's contentions, are abundantly

supported by the evidence, are not shown to be in anywise erroneous, and should therefore be affirmed upon review.

Thus, the evidence clearly shows that the transaction was in substance a sale of two classes of property for a lump-sum consideration without a *bona fide* agreement of the parties as to the price of each class. The taxpayer declined the purchaser's offers to buy the wine in carload lots, and would sell his entire inventory of wine only along with the winery plant and equipment. Upon ascertaining the OPA flat ceiling price for the sale of such wine, the taxpayer had the contract of sale drafted accordingly, to which the purchaser agreed because it made no difference to it either way so long as it acquired the taxpayer's total quantity of 275,000 gallons of wine contracted for. Nor did the purchaser actually want the winery but agreed to take it along with the wine in order to obtain the latter, which it really wanted.

Moreover, while the purchaser entered on its books the figures shown in the contract of sale and reported them in its tax returns, nevertheless this was of no significance for it merely thereby formally followed the written contract of sale, as the Tax Court found. However entered on the books and reported in its tax returns, the purchaser could in any event obtain the benefit of loss deductions and minimum taxes upon disposition of the wine and winery in the same year. In these circumstances, while the negotiations for the sale were arm's length transactions in so far as the determination of the *total* selling price was concerned, yet this cannot be said of the allocation provisions inserted in the contract of sale at the taxpayer's behest for they are not shown to have served any fundamental or functional purpose in the actual performance of the contract, other than possible tax avoidance. Accordingly,

it is clear that the Tax Court was fully warranted in making the allocations of the total proceeds received from the sale to each the wine and the winery in appropriate amounts. Notwithstanding the express language of the allocation provisions of the written contract of sale, a consideration of the record as a whole shows quite clearly that they do not reflect the actual substance of the agreement and the real intent of the parties to the transaction in question; rather, they show that the sale transaction involved in fact a single, indivisible contract for the sale of both the wine and the winery for a total lump consideration, and not the sale of each for a separate money consideration as claimed by the taxpayer.

Finally, the evidence shows that the Tax Court properly allocated the total selling price between the wine and winery based on the evidence and the resulting finding of the actual fair market value of the wine at the time of the sale. This was based on the testimony of several disinterested witnesses as to the fair market value of such wine sold under the permissible method used by the taxpayer to dispose of his wine, namely, the sale of both wine and winery in one package unaffected by the OPA price ceiling regulations. This clearly contradicted the taxpayer's conflicting and incredible testimony. Moreover, Tiara's sale of the winery thereafter for $20,000 conclusively shows, we submit, that it certailny did not pay $273,000 for the winery as set forth in the contract of sale to suit the taxpayer's fancy tax-wise, as shown by the testimony of its president and general manager Victor Dumbra; at most, according to the evidence, it really paid not more than $75,000 for the winery, as allocated thereto by the Tax Court. It follows that the balance ($275,000) must necessarily have represented the true sale price of the wine, as found by the Tax Court upon all the evidence.

ARGUMENT

The Tax Court's Finding, Based Upon All the Evidence, Reallocating the Total Proceeds Received by the Taxpayer as a Lump-Sum Payment from the Sale of Both His Wine Inventory and Winery Plant Between Ordinary Income and Capital Gain, Respectively, on the Basis of the Fair Market Value of the Wine, Is Not Shown to be Clearly Erroneous.

The question presented for decision is whether the Tax Court correctly found, upon all the evidence, that the substance of the transaction between the taxpayer and Tiara for tax purposes was an arm's length sale of two classes of property for one price for both, without a ceiling price to limit the consideration or any agreement of the parties as to the selling price of each class of the property, and that therefore a proper allocation of the total proceeds of $350,000 received by the taxpayer as a lump sum payment from the sale of both his wine inventory and winery plant between ordinary income and capital gain is $275,000 for the wine sold at $1 a gallon and $75,000 for the winery plant.

Stated otherwise, the issue involves the ascertainment of the real substance of the sale transaction in which the taxpayer sold his 275,000 gallons of wine together with his winery plant for a total consideration of $350,000, and in turn a determination as to whether the self-serving and wholly inoperative provisions of the contract of sale, arbitrarily allocating the selling price between the wine and winery in the respective amounts of $77,000 and $273,000, are binding on the Commissioner for income tax purposes.

The Tax Court, upon a review of all the evidence, facts and circumstances considered as a whole, found that the written contract of sale in question does not reflect the actual agreement of the parties; that the substance of the transaction between them for tax purposes is an arm's length sale of two classes of property—

wine inventory and winery plant—for the total amount of $350,000 for both, without a ceiling price to limit the consideration or any agreement of the parties as to the selling price of each class of property; that it was therefore proper for the Commissioner to have made an allocation reflecting the consideration paid for the wine and for the winery (R. 77, 78); and, ultimately, that of the total consideration of $350,000 involved in the transaction, the wine was sold for $1 a gallon, or $275,000, and the remainder of $75,000 represents the selling price of the winery (R. 70, 79). The taxpayer claims that this is error. (Br. 19-55.)

The taxpayer contends, substantially as in the Tax Court (R. 70), that he entered into an arm's length transaction for the sale of his wine inventory for $77,000 and the winery plant for $273,000, which agreement was embodied in the contract of sale, and therefore the contract, not being a sham, may not properly be disregarded by the Commissioner and the Tax Court (Br. 19-42). He argues further that the fair market value of the wine could not have exceeded its ceiling price established by the OPA, and that it was therefore error for the Tax Court to assign a higher selling price to it as the fair market value (Br. 43-55), the Tax Court's findings to the contrary purportedly not being supported by substantial evidence (Br. 42-43). The selling price claimed by the taxpayer for the wine came to 28¢ a gallon (R. 60), which he contends was the maximum limit for which he could sell the wine under the OPA price regulations in effect at the time of the sale in December, 1943 (Br. 23, 41). He therefore contends, in effect, as in the Tax ourt (R. 70-71), that the contract was a divisible contract involving separate independent sales of the wine and the winery for separate money considerations.

It is our position (a) that the transaction in substance was a sale of two classes of property for the lump-sum consideration of $350,000, without any *bona fide* agreement of the parties as to the real sale price of each, and consequently the Tax Court properly sustained in large part, with appropriate modifications, the Commissioner's allocation between ordinary income and capital gain of the proceeds of the sale to the wine and the winery on the basis of the fair market value of the wine, in excess of the OPA ceiling price, at the time of the sale in December, 1943; and (b) that while the negotiations for the sale were arm's length transactions in respect of the determination of the total selling price of $350,000 for both the wine and the winery, as contended by the taxpayer, yet this is clearly not true with respect to the allocation provisions of the contract of sale which, at the taxpayer's request, were inserted in the contract and consented to by thepurchaser—to whom it made no difference either way—merely as an accommodation to the taxpayer, particularly in the light of the consideration that such provisions are not shown to have served any fundamental or functional purpose in the actual performance of the contract, except tax avoidance. The evidence in support thereof is clear and convincing, and upon a careful scrutiny of the transaction in question as to the real intent of the parties, it impeaches, as *mala fides* and unsustainable, the arbitrary allocation provisions of the written contract of sale in so far as they affect and substantially decrease the true income tax liability of the taxpayers for the taxable year involved, as the Tax Court in effect found and held. (R. 70-79.)

A. The Transaction in Substance Was a Sale of Two Classes of Property for the Lump-Sum Consideration of $350,000, Without Any Bona Fide Agreement of the Parties as to the Real Price of Each

Whether there was an arm's length transaction for the sale of both the wine and the winery made pursuant to separate negotiations as to each at the fixed prices set forth in the contract of sale, as contended by the taxpayer, or a sale of both classes of property for a lump sum requiring allocation as to each class, as contended by the Commissioner, was clearly a question of fact to be determined by the trier of facts from a consideration of all the evidence; and the substance thereof must be ascertained from all the relevant facts and circumstances of the transaction taken into account and considered as a whole, as the Tax Court held. (R. 70-71.) *Commissioner* v. *Court Holding Co.,* 324 U. S. 331, 333-334; *United States* v. *Cumberland Pub. Serv. Co.,* 338 U. S. 451, 454.

The Tax Court, upon the basis of all the evidence, facts and circumstances considered as a whole, made ultimate findings as follows (R. 70, 77, 78, 79):

> Of the total consideration of $350,000 involved in the transaction, $275,000 was paid for the wine and $75,000 for the winery.
>
> *　　*　　*　　*　　*
>
> We conclude from a consideration of all of the evidence here that the written contract of sale does not reflect the agreement of the parties and the substance of the transaction between them was a sale of the wine and winery for $350,000 without any agreement on a selling price for each class of property. * * *
>
> *　　*　　*　　*　　*
>
> The substance of the transaction here for tax purposes, as already pointed out, is an arm's length sale of two classes of property for one price for

> both without a ceiling price to limit the consideration. * * *
>
> *   *   *   *   *
>
> Considering all of the evidence on the question we conclude that the wine was sold for $1 a gallon, or $275,000, and that the remainder of $75,000 represents the selling price of the winery.

These findings, contrary to the taxpayers' contentions (Br. 42-43), are supported by an abundance of evidence, clear and convincing, and have not been shown to be clearly erroneous. The taxpayer does not and can not show that they are in any wise erroneous. It was the function of the Tax Court to weigh and draw its own inferences from the evidence, conflicting or otherwise.[4] *United States* v. *Yellow Cab Co.,* 338 U. S. 338, 342; *United States* v. *Real Estate Boards,* 339 U. S. 485, 495-496. Moreover, it is axiomatic that the trial judge is not required to accept uncontradicted testimony where there are facts or circumstances which tend to refute it, as here. *Quock Ting* v. *United States,* 140 U. S. 417, 420-421, 422; *Sartor* v. *Arkansas Gas Corp.,* 321 U. S. 620, 627-628; *Menefee* v. *W. R. Chamberlin Co.,* 176 F. 2d 828, 833, fn. 11, modified and affirmed, 183 F. 2d 720 (C. A. 9th); *Broadcast Music* v. *Havana Madrid Restaurant Corp.,* 175 F. 2d 77 (C. A. 2d); *Spero-Nelson* v. *Brown,* 175 F. 2d 86, 90 (C. A. 6th); *First National Bank* v. *Commissioner,* 125 F. 2d 157 (C. A. 6th); *Burka* v. *Commissioner,* 179 F. 2d 483 (C. A. 4th); *Greenfeld* v. *Commissioner,* 165 F. 2d 318 (C. A. 4th). This rule applies even as to the taxpayer's testimony of intention. *Wil-*

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[4] In this connection the Tax Court stated (R. 72) that "No useful purpose would be served by a detailed discussion of all of the conflicting evidence."

mington Co. v. *Helvering,* 316 U. S. 164, 167; *Helvering* v. *Nat. Grocery Co.,* 304 U. S. 282, 295. Nor is the Tax Court bound to accept uncontroverted testimony "when there are facts which even indircetly may give rise to inferences contradicting the witness." *Cohen* v. *Commissioner,* 148 F. 2d 336, 337 (C. A. 2d). It is settled that so long as the trial tribunal's findings are supported by the evidence and are not shown to be clearly erroneous, as here, due regard being given to the opportunity of the trier of facts to judge the credibility of the witnesses, they may not properly be set aside but should be accepted on appeal. Rule 52 (a), Federal Rules of Civil Procedure; *United States* v. *Gypsum Co.,* 333 U. S. 364, 395-396, rehearing denied, 333 U. S. 869; *Commissioner* v. *Court Holding Co.,* 324 U. S. 331, 333-334; *United States* v. *Cumberland Pub. Serv. Co.,* 338 U. S. 451, 456; *Joe Balestrieri & Co.* v. *Commissioner,* 177 F. 2d 867, 873-875 (C.A. 9th); *Ruud* v. *American Packing & Provision Co.,* 177 F. 2d 538 (C.A. 9th); *Grace Bros* v. *Commissioner,* 173 F. 2d 170 (C.A. 9th).

In the first place, we recognize that the taxpayers are entitled to decrease the amount of what otherwise would be their taxes or altogether avoid them by any *bona fide* means which the law permits (*Gregory* v. *Helvering,* 293 U. S. 465, 469; *Commissioner* v. *Tower,* 327 U. S. 280, 288); and that where the law is clear as to tax consequences resulting from a particular course of action, such course of action will be given effect and be governed by the clear provisions of the law, even though it was followed for the primary purpose of tax avoidance (*United States* v. *Cumberland Pub. Serv. Co.,* 338 U. S. 451). But where tax avoidance is the primary motive of a particular transaction, as we submit is the clear case here, that transaction should be closely scrutinized for the purpose of revealing the substance which

will prevail over form. *Yiannias* v. *Commissioner,* 180 F. 2d 115 (C.A. 8th).

The Commissioner most earnestly submits that where, as here, coincidently and contemporaneously with the sale of both wine and winery the taxpayer, with the consent of the purchaser, juggled the figures in the contract of sale for the obvious reason of avoiding taxes by showing therein ordinary income taxable in full at higher rates ostensibly as capital gains taxable only to the extent of 50% thereof at lesser rates (as shown hereinafter), the line of delineation marking out the field of legitimate tax avoidance has been breached. In this light, the Tax Court, looking through form to substance and giving effect to realities, had no alternative than to find that the written contract of sale does not reflect the real agreement of the parties and the substance of the transaction in question. (R. 77.) Tax consequences are dependent upon the real nature of the transaction, not on the label attached to it by the parties. *Strauss* v. *Commissioner,* 168 F. 2d 441, 442 (C.A. 2d), certiorari denied, 335 U. S. 858, rehearing denied, 335 U. S. 888. As this Court stated in *Nordling* v. *Commissioner,* 166 F. 2d 703, 704, certiorari denied, 335 U. S. 817, "In tax matters the realities of a transaction, not artificialities, are given effect." See also *Gregory* v. *Helvering,* 293 U.S. 465, 469.

Next, as the Tax Court, citing *Commissioner* v. *Court Holding Co.,* and *United States* v. *Cumberland Pub. Serv. Co.,* both *supra,* properly stated (R. 71), the contract of sale here (R. 45-46, 66) is not controlling if its form differs from the substance of the transaction which, as pointed out, must be ascertained from *all* the evidence and circumstances with respect to the entire transaction considered as a whole. The quotation taken from the *Court Holding Co.* case by the Tax

Court (R. 71) is so apt that we repeat it here. There the Supreme Court, considering whether the sale was in substance made by the corporation or by its stockholders, stated (324 U. S. 331, 333-334):

> There was evidence to support the findings of the Tax Court, and its findings must therefore be accepted by the courts. *Dobson* v. *Commissioner,* 320 U. S. 489; *Commissioner* v. *Heininger,* 320 U. S. 467; *Commissioner* v. *Scottish American Investment Co.,* 323 U. S. 119. On the basis of these findings, the Tax Court was justified in attributing the gain from the sale to respondent corporation. The incidence of taxation depends upon the substance of a transaction. The tax consequences which arise from gains from a sale of property are not finally to be determined solely by the means employed to transfer legal title. Rather, the transaction must be viewed as a whole, and each step, from the commencement of negotiations to the consummation of the sale, is relevant. A sale by one person cannot be transformed for tax purposes into a sale by another by using the latter as a conduit through which to pass title. To permit the true nature of a transaction to be disguised by mere formalisms, which exist solely to alter tax liabilities, would seriously impair the effective administration of the tax policies of Congress.

Likewise, in the *Cumberland Pub. Serv. Co.* case, also quoted in part by the Tax Court (R.71-72), the Supreme Court, resting its decision, as in the *Court Holding Co.* case, upon the ultimate finding of the trial court, stated (338 U. S. 451, 456) that —

> It is for the trial court, upon consideration of an entire transaction, to determine the factual category in which a particular transaction belongs.* * *

It distinguished but reaffirmed (p. 454, fn. 3) its holding in the *Court Holding Co.* case, as follows:

> What we said in the *Court Holding Co.* case was an approval of the action of the Tax Court in looking beyond the papers executed by the corporation and shareholders in order to determine whether the sale there had actually been made by the corporation. We were but emphasizing the established principle that in resolving such questions as who made a sale, fact-finding tribunals in tax cases can consider motives, intent, and conduct in addition to what appears in written instruments used by parties to control rights as among themselves. See, e.g., *Helvering* v. *Clifford,* 309 U. S. 331, 335-337; *Commissioner* v. *Tower,* 327 U. S. 280.

Compare also *Commissioner* v. *Culbertson,* 337 U. S. 733, 742. Hence, the decision in the present case should, we submit, likewise rest upon the ultimate findings of the Tax Court, supported as they are by substantial evidence.

A resume of the crucial findings of the Tax Court (R. 60-70) discloses that the taxpayer sold his entire winery business, including the wine, under the contract of sale of December 6, 1943, to Tiara for $350,000. The buyer was mainly interested in buying the wine but was willing to buy the winery plant, if necessary, in order to get the seller's inventory of wine. The taxpayer was not interested in selling the wine alone because it cost him 50¢ a gallon to make, and the OPA ceiling price on sales thereof by him was 28¢ a gallon. The wine was worth $1 a gallon on the free market. The contract of sale specifically stated the consideration as $273,000 for the winery and $77,000 (28¢ a gallon) for the 275,000 gallons of wine sold. The Tax Court reallocated the proceeds from the sale as $275,000 ($1 a gallon) re-

ceived for the wine and the remainder of $75,000 for the winery.

The Tax Court's reallocation increased the tax because it greatly reduced the taxpayer's otherwise deductible loss on the sale of the wine, threw most of the one-half taxable capital gain on the sale of the winery back into ordinary income, and made most of his gain taxable as ordinary income instead of as capital gain. The taxpayer's allocating only $77,000 to the wine—representing the OPA ceiling price of 28¢ a gallon (R. 60, 67)—and $273,000 to the winery plant in the contract of sale (R. 45-46, 66), and thereupon reporting capital gain on the sale of the latter and ordinary income on the former in his and his wife's community income tax returns accordingly (R. 70), greatly reduced their income tax liabilities for the taxable year (R. 70). Only 50% of the greater part of the proceeds ($273,000) attributed to the sale of the winery plant, a capital asset, would thereby be taken into account in computing the long-term capital gain thereon which is taxable under Section 117 (a) (1) and (4), (b) and (c)(2) of the Internal Revenue Code (Appendix, *infra*); and only the relatively small portion of the proceeds ($77,000) attributed to the sale of the wine would be taxable in full amount as ordinary income at the much higher rates under Sections 11, 12 and 22(a) of the Code (Appendix, *infra*). Thus, by the mere expediency of juggling the figures in the contract of sale, with the consent of the purchaser, the taxpayers clearly hoped to be able to avoid many thousands of dollars income taxes. (R. 11-18, 31-33, 70.) On the other hand, it was a matter of utter indifference and wholly immaterial to the purchaser as to how the taxpayer thus allocated the selling prices to the winery and the wine in the contract of sale (R. 77), as Tiara's representative John Dumbra informed the taxpayer antici-

patory to drawing up the contract, "as long as the total price will not exceed $350,000, and the gallonage is correct" (R. 577), as the taxpayer admits (Br. 26, fn. 14). The reason therefor was that so long as the purchaser sold the wine and the winery in the same year, any loss incurred on the resale of the winery would be deductible in full under Section 117(b), and could be offset against the inordinately high profits realizable upon the sale of the wine with the relatively low book cost of 28¢ a gallon. (R. 68, 76.) Hence, the effect would be the same tax-wise for the purchaser regardless of how the taxpayer specified the selling prices of the wine and winery in the contract of sale and/or how they were recorded in the purchaser's books and reported by it for tax purposes.

The facts antecedent to the sale show quite plainly that the transaction was in substance a sale of two classes of property, together, for the lump sum consideration of $350,000. Thus, upon Tiara's first offering to purchase three or four carloads of the taxpayer's wine, the latter declined to sell it alone and insisted upon selling the entire inventory of wine together with the winery plant for a total sum in such amount only. (R. 573-574.) The taxpayer wanted to "make the wine one figure and the plant another figure, but it would be a total price" (R. 577), without any mention of the selling price of wine under the then existing OPA price control regulations (R. 580-581, 583-584). Witness John Dumbra testified that "Mr. Particelli said that he was going to draw up the whole thing together, and the price would be $350,000." (R. 577.) The purchaser's representative failing to get the price down to $330,000 for both wine and winery, as desired by Tiara, agreed to the taxpayer's price of $350,000, and, as pointed out, agreed further that the contract would be drafted to suit the taxpayer's fancy, provided the price did not

exceed the latter amount and there were at least 275,000 gallons of wine available for Tiara. (R. 74, 578). The taxpayer then ascertained that the flat ceiling price for the sale of current dry red wine in bulk was 28¢ a gallon, and thereupon having computed that the 275,000 gallons of wine would come to $77,000 at that price, requested his lawyer to draft the contract of sale accordingly (R. 66-67, 577-578, 623-624)—as the instrument now appears in evidence (R. 45-46, 66). Only a few weeks before the sale to Tiara the taxpayer had been advised by his accountant of the difference between ordinary income and capital gain for tax purposes, and the consequent benefit tax-wise to be derived by selling both the wine and the winery plant together (R. 272-274), as was done here. Tiara did not want the winery but agreed to purchase it because that was the only way it could acquire the wine which it did want. (R. 68, 591-593, 621-622.)

While Tiara entered the wine inventory and winery plant and equipment on its books in accordance with the allocation provisions which the taxpayer, upon Tiara's acquiescence, had inserted in the contract of sale, and used such figures for income tax purposes (R. 57-58, 610-612), it did so merely to follow the written contract of sale, it having been immaterial to it how the total sales price was allocated in the contract of sale between the wine and winery by the taxpayer, as heretofore shown. It is apparent that Tiara did not consider the winery worth any such amount as $273,000 even though thus entered on its books. Victor Dumbra, its president and general manager, having made a mental calculation, when considering the purchase of the winery along with the wine, that it "might be" worth $50,000 to $60,000 (R. 597), and Tiara, unable to get any such offers and therefore having sold it for $20,000 about a year later (R. 69, 76), are proof positive that

it was worth nowhere near such amount, and that Tiara would not have agreed and did not agree to pay any such amount therefor, as the Tax Court found (R. 76). In any event, as the Tax Court found further (R. 76), contrary to the taxpayer's contentions (Br. 28-29), Tiara's book entries showing costs of $77,000 and $273,-000 for the wine and the winery, respectively, are not conclusive—"The books merely follow the written contract of sale", as the Tax Court put it (R. 76). Such entries are "no more than evidential, being neither indispensable nor conclusive" (*Doyle* v. *Mitchell Bros. Co.,* 247 U. S. 179, 187; *Gulf Oil Corp.* v. *Lewellyn,* 248 U. S. 71; they are merely expressions of opinion and only as valuable as other opinions (*Royal Packing Co.* v. *Lucas,* 38 F. 2d 180, 182 (C.A. 9th); and they are only *prima facie* evidence of what they show, and always yield to evidence of the real facts (*Pottash Bros.* v. *Burnet,* 50 F. 2d 317, 319-320 (C.A.D.C.); *Great Northern Ry. Co.* v. *Commissioner,* 40 F. 2d 372 (C.A. 8th), certiorari denied, 282 U. S. 855), such as those here, for example.

In these circumstances, while the negotiations for the sale were arm's length transactions in so far as the determination of the total selling price of $350,000 for both wine and winery were concerned, as pointed out, nevertheless this obviously can not be said of the allocation provisions inserted in the contract of sale at the taxpayer's request. This is particularly true in the light of the consideration that the allocation provisions in the contract are not shown to have served any fundamental or functional purpose in the actual performance of the contract, other than clearly contemplated tax avoidance. Hence, it is abundantly plain, we submit, that the evidence is clear and convincing in impeaching, as *mala fides,* the allocation provisions of the written contract of sale in so far as they affect the income taxes

of the taxpayer, one of the parties thereto, and of his wife's estate. Consequently, the Tax Court, sustaining the Commissioner's determination of allocations in large part, was fully warranted, upon the basis of all the evidence, in making appropriate modified allocations of the proceeds received from the sale as a lump-sum price properly to reflect the consideration paid for each the wine inventory and the winery plant. (R. 77-79.) *Stern* v. *Commissioner,* 137 F. 2d 43, 46 (C.A. 2d); *Deutser* v. *Marlboro Shirt Co.,* 81 F. 2d 139, 142 (C.A. 4th);[5] *Haverty Realty & Investment Co.* v. *Commissioner,* 3 T.C. 161, 167; compare *Lakeside Irr. Co.* v. *Commissioner,* 128 F. 2d 418 (C.A. 5th), certiorari denied, 317 U. S. 666; *M. F. Reddington Co.* v. *Commissioner,* 131 F. 2d 1014 (C.A. 2d); *Morris Investment Corp.* v. *Commissioner,* 156 F. 2d 748 (C.A. 3d), certiorari denied, 329 U. S. 788; *Williams v. McGowan,* 152 F. 2d 570 (C.A. 2d); *Graham Mill & Elevator Co.* v. *Thomas,* 152 F. 2d 564 (C.A. 5th); *Warner Co.* v. *Commissioner,* 11 T. C. 419, 430, affirmed *per curiam,* 181 F. 2d 599 (C.A. 3d) (approving Commissioner's and Tax Court's allocation of principal and interest upon corporation's repurchase of its own bonds (issued at a discount), effecting liquidation, by lump-sum settlement, of its entire indebtedness of principal and interest for less than the face amount.

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[5] Contrary to the taxpayer's contentions (Br. 24-26, 36-38), the court, in the *Deutser-Marlboro Shirt Co.* case, citing many authorities, *q.v.,* held (p. 142) that—

> the recitals of a written instrument as to the consideration received are not conclusive, and it is always competent to inquire into the consideration and show by parol or other extrinsic evidence what the real consideration was. * * *

B. Notwithstanding the Express Language of the Allocation Provisions of the Written Contract of Sale, They Do Not Reflect the Actual Substance of the Agreement and the Intent of the Parties

A consideration of all the facts and circumstances makes it manifest that the sale transaction in fact involved a single, indivisible contract for the sale of both the wine and the winery for the total lump-sum consideration of $350,000, and not a sale of each for a seperate money consideration as claimed by the taxpayer. (R. 70-71.) As pointed out, the allocation provisions of the contract were not only wholly inoperative but served no functional purpose in effecting the sale transaction. Moreover, despite the express language of those provisions the parties themselves cleary did not consider the selling price of the wine to be the bulk selling price of 28¢ a gallon as fixed by the OPA regulations, but rather approximately $1 a gallon as determined by the Tax Court upon the basis of the fair market value thereof. (R. 75-76, 78-79.) A consideration of the terms of the written contract, together with the actions of the parties in negotiating its execution, clearly supports this. Under the performance paragraph of the contract [6] (R. 46, 66), the purchaser promised to pay the entire balance of $345,000 [7] in exchange for the taxpayer's promise to furnish clear title to all the real and personal property promised thereunder.

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[6] The provisions of that paragraph read as follows (R. 46):

> It is further understood and agreed that the balance of said total purchase price for both the said winery and wine, amounting to $345,000.00, will be paid on or before December 21, 1943, at which time said G. Particelli agrees to furnish clear title to said real and personal property.

[7] A down payment of $5,000 had previously been made to the taxpayer. (R. 45, 66.)

Hence, this was the actual undertaking of the parties, unaffected by the allocation provisions, attributing $273,000 to the winery and only $77,000 to the 275,000 gallons of wine sold and inserted in the contract at the insistence of the taxpayer, purporting thus to allocate the total selling price between the two items for no other purpose, in so far as shown, than to anticipate advantageous tax consequences. This, therefore, did not effect a divisible contract in respect of those two items sold for whatever performance was required of the taxpayer, the only performance required by the purchaser in turn was the single act of payment on a date certain of the entire balance ($345,000) due on the contract for both items. The contract was performed substantially in accordance with its terms and the entire balance of the purchase price was paid over to the taxpayer out of the escrow in exchange for the bills of sale for the wine and winery, even though the deed to the latter could not be and was not delivered to the purchaser until some months thereafter when the basic permit therefor was issued by the Treasury Department. (R. 67-68.) This is precisely what the parties had agreed to in order for the taxpayer to get his full selling price of $350,000, and for the purchaser to get the 275,000 gallons of wine, with or without the winery, as plainly indicated by the evidence.

Thus, witness Victor Dumbra, president of Tiara, in reply to the question as to what relative values he placed on the wine and winery in respect of the total figure of $350.000, answered (R. 597), "Well, quite frankly we didn't place an exact value on the plant. We took more into consideration how much wine was in the plant * * * [which by] mental calculation * * * might be worth [only] fifty, sixty thousand dollars for

the plant'', without knowing its actual value.[8] This indicated quite clearly that the balance of approximately $300,000 was being paid for the wine alone, regardless of whether or not the purchaser could acquire title to the winery plant. There is nothing to indicate, on the other hand, that the taxpayer would have given the purchaser a bill of sale to the 275,000 gallons of wine upon the latter's payment of $77,000 therefor, as specified in the contract of sale. (R. 46, 66.) On the contrary, it is quite clear that he definitely would not have done so for even though he told John Dumbra, the representative of the purchaser who negotiated the deal for Tiara, that he would state the price of ''the wine [at] one figure and the [winery] plant [at] another figure'' at ''a total price'', yet he made it very clear that ''he was going to draw up the whole thing together, and the price would be $350,000.'' (R. 577.) Tiara, through Dumbra, however, never entered into separate agreements with the taxpayer to purchase the wine inventory for $77,000 and/or the winery plant for $273,-000 as specified in the contract of sale. (R. 65, 579.)[9] In any event, the taxpayer refused to sell the wine alone for, as he told witness John Dumbra (R. 580-581, 583),

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[8] Witness Victor Dumbra's full answer to the question was as follows (R. 597):

> Well, quite frankly we didn't place an exact value on the plant. We took more into consideration how much wine was in the plant, and then said, well, mental calculation, it might be worth fifty, sixty thousand dollars for the plant. We wouldn't know the exact value, as far as I was concerned.

[9] As against this, the taxpayer had testified that in the negotiations with John Dumbra he had agreed to sell ''*all* [his] wine in the winery, lees and everything'' at the ceiling price, and that thereafter Dumbra, admiring the winery and as an afterthought, initiated the discussion which resulted in the sale of the $30,000 winery ostensibly for the price of $273,000. (Italics supplied.) (R. 106, 107.)

he could not make a profit on such sale, and therefore insisted that Tiara buy all his wine and the winery together for the express purpose of exempting the sale from the scope of the OPA price control regulations [10] (R. 580-583).

The evidence shows that the parties themselves, notwithstanding the provisions of the contract of sale to the contrary, did not in fact really intend or consider that the selling price of the wine was only $77,000 and the winery $273,000, for the facts show that both parties to the transaction considered that the purchaser was paying from $1 to $1.12 a gallon for the wine, totaling approximately $300,000, and that the balance of the purchase price was paid for the winery, as pointed out, in harmony with the testimony of Victor J. Dumbra, president and general manager of purchaser Tiara.[11]

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[10] In December, 1943, the taxpayer, after he had entered into the contract of sale with Tiara, told his old friend Alberigi that he had sold 400,000 gallons of wine at $1 a gallon (R. 362), and having sold it for "one dollar a gallon", in order to make it legal under OPA regulations he had thrown in the winery and good will (R. 75, 360-362).

[11] In this connection, the testimony of Victor J. Dumbra shows the following (R. 623-624):

> Q. * * *. I think you testified a moment ago that so far as you were concerned you regarded *the actual cost of this wine to be approximately $300,000 for the entire batch,* and that the balance of the difference between that and the total figure to be approximately what it was costing you for the winery? [Italics supplied.]
>
> A. I say, that was my mental observation.
>
> Q. Yes.
>
> A. But it didn't reflect that on the books.
>
> Q. You didn't reflect that on the books, and what was the reason you didn't reflect it on the books?
>
> A. The contract is the obvious answer.

(R. 597, 624.) Attempts by the taxpayer's counsel to mitigate the damaging effect of that testimony by pointing out to witness Dumbra that Tiara had entered the wine and winery plant on its books at $77,000 and $273,000, respectively, were abortive for the witness made it clear that the transaction had been handled on its books and tax returns in that way by their accountant Brown merely because they were the figures appearing in the contract of sale, and not as representing the actual cost of the wine and winery, and were entered in the books accordingly by their accountant.[12] (R. 57-58, 610-612.) As pointed out, it was wholly immaterial to Tiara whether or not there was any allocation of the total purchase price between the wine and the winery so long as it sold the wine and the winery in the same year (R. 623), and thereby obtained the benefit of offsetting losses and gains against each other on its tax returns.

Finally, conclusively showing what the parties really considered the wine was actually bought and sold for were the adjustments which they found it necessary to make in their accounts because of the fact that the taxpayer had withdrawn 1,000 gallons of wine from the inventory sold, for his own use some time in December, 1943, before the closing of the escrow. The evidence shows that the adjustment was made for $1,000 in favor of Tiara for the 1,000 gallons of wine withdrawn

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[12] The decision to make these entries in Tiara's books in this way and report them accordingly in its tax returns was made solely by their accountant Brown, Victor J. Dumbra having found out about it only some time later. (R. 610-611.) While, of course, it would have been technically more accurate to have reflected the true costs in the books and tax returns instead of those appearing in the contract of sale, nevertheless it is clear that the procedure followed involved no misfeasance on the part of Tiara. (R. 621-624.)

from that sold by the taxpayer, which obviously was at the rate of $1 a gallon as the fair estimate of the amount paid by Tiara for the same wine under the contract of sale before withdrawn by the taxpayer.[13] (R. 69-70, 75.) As the Tax Court found (R. 75), upon the taxpayer's making settlement with Tiara for its indebtedness to him for services rendered it after the sale (R. 69-70), he agreed to the application of the credit of $1,000 at the rate of $1 a gallon for the 1,000 gallons withdrawn after the sale for his personal use, later testifying, however, that the adjustment was on the basis of the selling price of 28¢ a gallon paid him under the contract of sale, and still later that it was a mistake of his or Tiara's attorneys (R. 75). The Tax Court found instead (R. 75), however, that the parties had agreed that the credit was a fair estimate of the amount paid the taxpayer by Tiara for the wine when purchased. This was fully established by Victor Dumbra's testimony that if Tiara had paid the taxpayer the full amount

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[13] The taxpayer apparently sensing the damaging effect of any evidence adduced in respect of this transaction (R. 75), resorted to contradictions and denials, first testifying that he had sold "all" the wine and "everything" he had in the winery, specifically, that "I sold everything I have in the winery" (R. 106, 132); later admitting, upon being pinned down, that he had taken out about 1,000 gallons, and when asked what adjustment had been made therefor, he stated that the adjustment was at the same price he had received for the wine, namely, the ostensible ceiling price of 28¢ a gallon (R. 132). Upon the Commissioner's introducing documentary evidence establishing that the adjustment for the 1,000 gallons was $1,000 (R. 601), the taxpayer testified upon redirect examination that the 1,000 gallons of wine he had withdrawn was some very high quality Italian Swiss Colony Wine (R. 200, 214-217). In so testifying, however, he had forgotten that he had previously testified in substance that all the wine involved in the sale was wine of his own making (R. 99, 132), as corroborated by the oral stipulation of the parties during the proceedings in the Tax Court (R. 153).

($1,500) owed him for his services (R. 69-70), "we would have expected $1,000 back in cash [for the wine withdrawn], definitely" (R. 601). In these circumstances, it is apparent that the self-serving allocation provisions of the written contract of sale were not only entirely inoperative and of no effect in the performance of the contract but also were wholly at variance with the actual substance of the transaction, the contract, contrary to the taxpayer's contentions (R. 70-71), clearly having been an indivisible one involving the sale of all the taxpayer's wine and the winery, together, for the total lump-sum price of $350,000, the allocation provisions of the contract, obviously designed primarily to advantage the taxpayer tax-wise and serving no functional purpose in the transaction, to the contrary notwithstanding. These considerations clearly show that the parties' allocation provisions in the sales contract were not arm's length but were designed merely as a matter of expediency for the taxpayer's benefit tax-wise; hence, the Tax Court was fully warranted in finding and concluding, upon all the evidence, that the wine was sold for $1 a gallon, or $275,000, and the remainder of $75,000 represented the selling price of the winery. (R. 70, 79.)

C. The Tax Court Properly Allocated the Total Selling Price Between the Wine and the Winery, Based on the Finding of the Actual Fair Market Value of the Wine at the Time of the Sale.

The Tax Court based its allocation of the total selling price to the wine and the winery primarily on the actual intent of the parties—as distinguished from the self-serving and wholly inoperative allocation provisions set forth at the taxpayer's request in the contract of sale — and, in substance, determined that the parties really *intended* to sell the wine and winery for the respective fair market values thereof as determined by

it upon a consideration of all the evidence, facts and circumstances. (R. 72-79.) Since the taxpayer successfully avoided the 28¢ OPA price ceiling by selling his wine and winery together here for a lump-sum price (R. 63, 72-73), as he had done in other instances without selling the winery (R. 61, 75, 168-171, 192-193, 358-359), and the evidence shows that the fair market value of ordinary current, dry, red wines to vintners to the trade under this permissible method was estimated and shown by the Commissioner's several witnesses to have been from 75¢ to $1.25 a gallon (R. 78-79, 315-317, 340-341, 352, 458-459, 600-601, 612), the record thus establishes the fact that, notwithstanding the attempted OPA price control, there was a free open market for the legitimate disposition of the vintners' wine to trade channels at the net rate of at least $1 a gallon to the vintner during all times material here.

Thus, witness Victor J. Dumbra, president and general manager of Tiara which bought the taxpayer's wine in question, testified that his company was actually paying $1 to $1.12 a gallon for the taxpayer's 275,000 gallons of wine—and the Tax Court so found (R. 68) —and that the winery was worth only about $40,000 to $60,000 (R. 79, 600-601, 612). Other witnesses (Mondavi and Gomberg) testified that the wine was worth $1 a gallon, and 75¢ to $1.25 a gallon, respectively. (R. 78-79, 315-317, 340-341, 352, 458-459.) Indeed, as pointed out, the taxpayer himself paid $1 a gallon for the 1,000 gallons of the same wine withdrawn from the inventory after the sale of *all* his wine had been made to Tiara. (R. 69-70, 75, 79, 601.) And only six months before the taxpayer's sale of all his wine to Tiara, the taxpayer had, contrary to the OPA price control reguations, sold more than 60,000 gallons of wine to the Sunset Winery of Ohio at a price somewhere between

70¢ and $1 a gallon.[14] (R. 168-171, 192-193.) Moreover, Tiara, upon offering the winery for sale for $60,000,

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[14] The taxpayer contends, incongruously, that the Tax Court's admitting in evidence, over his objections, testimony in respect of a crime of which he had never been convicted—taxpayer's sale of about 60,000 gallons of wine, over the OPA ceiling price of about 27½¢ a gallon, at approximately 86¢ a gallon during the same period involved here (R. 61; Br. 14)—was error warranting reversal of its decisions here (Br. 12-19). This contention is clearly without merit for the record plainly shows that the Tax Court admitted such evidence (R. 530-531), over the taxpayer's objections (R. 523-528), as adduced by the Commissioner (R. 521-523, 529-531), not for the purpose of laying a foundation for the taxpayer's prosecution (R. 524, 528), as feared by the taxpayer (R. 524-525, 527-528)—the OPA penal statutes having already expired (R. 524)—but solely to rebut the taxpayer's testimony that he had never sold wine over the established OPA ceiling prices (R. 523, 526-527), and it made a finding in respect thereto accordingly (R. 61). This evidence was brought out by the Commissioner merely for the purpose of showing, collaterally (R. 526-527), that the taxpayer, of his own admission, had made other sales of wine over the established ceiling prices during the period involved here (R. 524, 526-527), and therefore showing in turn the disingenuousness and unreliability of his claim of the sale here of his 275,000 gallons of wine purportedly at the prevailing OPA ceiling price of 28¢ a gallon during the same period (R. 45-46, 66). It will be noted that the Tax Court, other than making a finding in respect to the illicit sale of 60,000 gallons (R. 61), and taking cognizance thereof along with other testimony as showing "all of the conflicting evidence" which it considered unworthy of detailed discussion (R. 72), never even considered the testimony objected to here in arriving at its decisions (R. 70-79). On the other hand, it did take cognizance of witness Aberigi's testimony (R. 358-359) of the taxpayer's other sale, made over the objections of his daughter, of 100,000 gallons of wine at 70¢ a gallon (R. 75). Hence, in the absence of any showing or indication that the Tax Court's decisions would not have been the same without such evidence, it is abundantly clear, we submit, that there was no harm done by its admission in evidence and, consequently, that there is no valid basis for the taxpayer's objections thereto.

shortly after having acquired title to the property in May or June of 1944 ostensibly for $273,000 (R. 45-46, 66), first rejected offers of $40,000 and $45,000, would have accepted $50,000 or $60,000, and finally sold it for $20,000 in December, 1944 (R. 69, 76). This, we submit, shows conclusively that Tiara did not really pay $273,000 for the winery and only $77,000 for the wine, as the taxpayers contend and the contract of sale purports to show (R. 45-46, 66), but that it was *in fact* the other way around, that is, it actually paid, at most, $75,000 for the winery and $275,000 for the wine on the basis of $1 a gallon fair market value, as the Tax Court found upon *all* the evidence, facts and circumstances (R. 70), and held accordingly (R. 79).

The taxpayers urge further that it was error for the Tax Court to assign a price higher than the prevailing OPA ceiling price to the wine because the fair market value thereof purportedly could not exceed its ceiling price. (Br. 43-55.) The short answer to that is, as pointed out, that while the fixed price ceiling of 28¢ a gallon obtained if the wine were sold by itself, yet when sold along with the winery plant, as here, there was admittedly no price ceiling restriction on the sale of the wine. (R. 63.) The taxpayers argue further (Br. 43-55), as in the Tax Court (R. 78), that if the fair market value is used as the basis, then no more than $77,000 could be ascribed to the wine since that represented the maximum ceiling price, reasoning that if the Government had requisitioned the wine in December, 1943, it would have paid the taxpayer only 28¢ a gallon for it, as the fair market value of the property, as compensation therefor, citing *United States* v. *Commodities Corp.*, 339 U. S. 121, and *United States* v. *Felin & Co.*, 334 U. S. 624, in support thereof (Br. 49-53). The Tax Court clearly distinguished those cases as having no factual basis for application here. (R. 78.) In

any event, the Supreme Court merely decided in those cases that the ceiling price for the particular property under consideration there constituted lawful just compensation to the owners, but the Court had no occasion to determine and made no determination at all that the ceiling price constituted the fair market value under the unusual facts of those cases. Here the ceiling price was substantially less than the cost; and therefore it may not be presumed, under the particular facts here, that the ceiling price of 28¢ a gallon would under any circumstances be determined to be just compensation in the event of requisition by the Government but rather, quite clearly, the fair market value of the wine then prevailing in the free market, as the Tax Court determined. (R. 78-79.) Consequently, the authorities relied on by the taxpayers do not support the proposition that the fair market value of vintners' wine in December, 1943, must be determined to be not more than the then-existing ceiling price of 28¢ a gallon.

In view of the foregoing, we submit that the evidence clearly establishes that the Tax Court's allocation of $275,000 of the total proceeds of the sale to the wine on the basis of $1 a gallon fair market value, and the remainder of $75,000 representing the selling price of the winery plant and equipment (R. 70, 79), is clearly correct, being based on the established fair market value of the wine in the free market shown to be actually existing at the time of the sale. It follows that the Commissioner and the Tax Court were not bound by the allocation provisions of the taxpayer's written contract of sale inasmuch as it fails to reflect the actual substance of the sale transaction and the intent of the parties thereto, the clear and convincing proof showing very plainly the *mala fides* of the contract in so far as it affects the income tax liability of the taxpayer, one of the parties thereto, as well as his wife's estate, a

party petitioner here. Cf. *Commissioner* v. *Court Holding Co.,* 324 U. S. 331, 333-334; *United States* v. *Cumberland Pub. Serv. Co.,* 338, U. S. 451, 454, 456; *Weiss* v. *Stearn,* 265 U. S. 242, 253, 254.

CONCLUSION

The decisions of the Tax Court are in all respects correct, and should therefore be affirmed by this Court.

Respectfully submitted,

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April, 1953.

Internal Revenue Code:

SEC. 11 [As amended by Sec. 102, Revenue Act of 1942, c. 619, 56 Stat. 798]. NORMAL TAX ON INDIVIDUALS.

There shall be levied, collected, and paid for each taxable year upon the net income of every individual a normal tax of 6 per centum of the amount of the net income in excess of the credits against net income provided in section 25. * * *
(26 U.S.C. 1946 ed., Sec. 11.)

SEC. 12. SURTAX ON INDIVIDUALS.

(a) *Definition of "Surtax Net Income".*—As used in this section the term "surtax net income" means the amount of the net income in excess of the credits against net income provided in section 25 (b).

(b) [As amended by Sec. 103, Revenue Act of 1942, *supra*] *Rates of Surtax.*—There shall be levied, collected, and paid for each taxable year upon the surtax net income of every individual the surtax shown in the following table:

* * * * *

[Here follow the rates of surtaxes, ranging from 13% on amounts of ordinary income not over $2,000, to $139,140, plus 82% of excess over $200,000.]

* * * * *

(26U.S.C. 1946 ed., Sec. 12.)

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, voca-

tions, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *
(26 U.S.C. 1946 ed., Sec. 22.)

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *Definitions.*—As used in this chapter—

(1) [As amended by Sec. 115 (b), Revenue Act of 1941, c. 412, 55 Stat. 687, and Sec. 151 (a), Revenue Act of 1942, *supra*] *Capital assets.*—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23 (l), * * *, or real property used in the trade or business of the taxpayer;

* * * * *

(4) [As amended by Sec. 150 (a), Revenue Act of 1942, *supra*] *Long-term capital gain.* The term "long-term capital gain" means gain from the sale or exchange of a capital asset held for more than 6 months, if and to the extent such gain is taken into account in computing net income;

* * * * *

(b) [As amended by Sec. 150 (c), Revenue Act of 1942, *supra*] *Percentage Taken Into Account.* In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net capital gain, net capital loss, and net income:

100 per centum if the capital asset has been held for not more than 6 months;

50 per centum if the capital asset has been held for more than 6 months.

(c) [As amended by Sec. 150 (c), Revenue Act of 1942, *supra*] *Alternative Taxes.*—

(c) [As amended by Sec. 150 (c), Revenue Act of 1942, *supra*] *Alternative Taxes.*—

* * * * *

(2) *Other taxpayers.*—If for any taxable year the net long-term capital gain of any taxpayer (other than a corporation) exceeds the net short-term capital loss, there shall be levied, collected, and paid, in lieu of the tax imposed by sections 11 and 12, a tax determined as follows, if and only if such tax is less than the tax imposed by such sections:

A partial tax shall first be computed upon the net income reduced by the amount of such excess, at the rates and in the manner as if this subsection had not been enacted, and the total tax shall be the partial tax plus 50 per centum of such excess.

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(26 U.S.C. 1946 ed., Sec. 117.)

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